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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 003161

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E.O. 12958: DECL: 05/18/2017
TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)
SUBJECT: RUSSIA: EXXONMOBIL ON SAKHALIN 1

Classified By: Econ MC Pam Quanrud for reasons 1.4 (b and d).

SUMMARY

¶1. (C) Summary: In a June 26 meeting, ExxonMobil Russia VP Ed Verona (protect) told us that Exxon has agreed with China on "price parameters" for gas deliveries from its Sakhalin 1 project. Reacting to recent press reports that Gazprom may try to force ExxonMobil to sell its gas to Gazprom or to domestic markets, Verona said Exxon would consider all commercially acceptable offers for its gas, but that it firmly believes a recent law granting a gas export monopoly to Gazprom does not apply to Sakhalin 1. He suggested Exxon would not bow to pressure to renegotiate its contract. End summary.

PSAS EXCLUDED FROM GAZPROM EXPORT MONOPOLY

¶2. (C) ExxonMobil Russia VP Ed Verona told us June 26 that Exxon's Production Sharing Agreement (PSA) allows it to sell gas from its Sakhalin 1 project to whomever it wants, domestically or abroad. The same legislation that gave Gazprom its gas export monopoly specifically excludes PSAs and therefore does not apply to Sakhalin 1. Negotiations continue with China over proposed sales of eight billion cubic meters (bcm) of gas annually from Sakhalin 1, and that the two sides have signed a "heads of agreement" (HOA) which Verona described as more advanced and specific than an MOU. The HOA lays out "price parameters" but not specific prices.

PIPELINE EXPORT TO CHINA MOST PROFITABLE

¶3. (C) Brushing off press reports that Gazprom may try to force Exxon to sell its gas to Gazprom or to domestic markets, Verona said that Exxon would consider all commercially acceptable offers. Internal Exxon analysis shows, however, that the current planned export route to China via pipeline will be the most profitable, not only for the company, but for the Russian government as well. Russian government revenues over the life of the project would be \$15 billion higher under the current plan than if the gas were to be sold to Gazprom for export via the Sakhalin 2 LNG

terminal. Despite press reports to the contrary, Verona reconfirmed on June 27 that Gazprom has yet to make a formal proposal to Exxon.

RFE CAN'T ABSORB SAKHALIN GAS

14. (C) Verona disagreed with recent GOR claims that the Russian Far East will need 15 bcm of gas annually. Exxon does not see a market for more than about 5 bcm of gas in the region, even under the rosy GOR scenarios involving new petrochemical and other "value added" industries.

CONTRACT SANCTITY

15. (C) Verona said ExxonMobil would stand firm against pressure from Gazprom or other Russian entities to renegotiate its Sakhalin 1 contract. If Exxon allows itself to "be rolled" by Gazprom in Russia, it might invite such tactics elsewhere in the world. He expressed hopes that the markets would impose some discipline on Russia.

COMMENT

16. (C) Gazprom is likely unhappy that Exxon is coming to its own agreement with China and that it may become a price setter with China. Gazprom's test balloon, via the press, is unlikely to cause Exxon to yield. The next move to watch is

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what, if any, concrete proposal Gazprom is willing to make.
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